VENTURE CAPITAL TERM SHEET

by

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Venture Capital Term Sheet

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MEMORANDUM OF PROPOSED TERMS
FOR PRIVATE PLACEMENT OF
SERIES A PREFERRED STOCK
January 31, 2006

Venture Investor, L.P. (the "Investor") is interested in making an investment in Newco, Inc. (the "Company") subject to satisfactory completion of further due diligence and final agreement on the terms and conditions stated below. This term sheet summarizes the proposed principal terms of the Series A Preferred Stock. This term sheet is not a formal commitment to invest, however, and any investment is subject to the completion of due diligence and documentation that is satisfactory to Investor and the Company.

Issuer: Newco, Inc., a Delaware corporation

Most investors prefer Delaware corporations. Some investors will allow incorporation in the Company's domestic state (e.g., Texas investors may be willing to invest in Texas corporations).

Securities to be Issued: Series A Convertible Preferred Stock (the "Series A Preferred Stock")

Aggregate Proceeds: $10,000,000

Investors:

Investor	$7,000,000
Other Investors	$3,000,000
Total	$10,000,000

The investors will often consist of one "lead" investor, other institutional investors, and several individuals related to the investors or the Company.

Purchase Price: Price per share to be based on fully diluted post-money valuation of [$25,000,000].

Expected Closing Date: On or before March 15, 2006

The time from term sheet to closing can vary significantly depending on numerous factors. As a rule, venture capital financings will close 4-8 weeks after execution of the term sheet.

Option Pool: The post-money valuation above assumes that, prior to closing, the total shares reserved under the Company's employee stock option plan will represent [x%] ownership of the Company on a fully-diluted basis.

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Investors expect that the Company will use options to attract and retain key employees and usually factor the option pool size into their valuation of the Company and assume that the full amount of the option pool is taken into account in determining the "pre-money" valuation of the Company.

Dividends: The Series A Preferred Stock shall receive an [x%] noncumulative dividend per year, when and if declared by the Board, in preference to the common stock.

This dividend provision is favorable to the Company as the directors need not pay a dividend unless they wish to pay dividends on common stock in the same year. Contrast to cumulative dividends whereby unpaid dividends will be added to the liquidation amount and the redemption price of the preferred stock and all accrued dividends for past as well as the current year must be paid prior to payment of dividends on common stock.

Liquidation Preference: Series A Preferred Stock holders will receive an initial payment equal to the purchase price of the Series A Preferred Stock plus accrued and unpaid dividends on each share of Series A Preferred Stock (the "Initial Liquidation Amount"). [After the Initial Liquidation Amount, the Series A Preferred Stock and common stock share on an as-converted basis until the holders of the Series A Preferred Stock have received, in the aggregate, an amount equal to [x] times their investment.]

There are many ways to structure this preference based on the existence of and limitations on returns received prior to distributions to common holders, returns received with common holders, and cumulative dividends. In subsequent financings, new series of preferred stock may have a superior position or be on a pari passu footing with this series with respect to liquidation. Companies may attempt to negotiate a cap on the liquidation preference so that investors choose to convert to common stock and give up the liquidation preference on a "home run" exit.

A merger, reorganization or sale of substantially all of the assets of the Company in which the stockholders of the Company immediately prior to such event do not own a majority of the outstanding shares of the surviving entity will be deemed to be a liquidating event.

In the case of a sale of the Company, the investors will have a choice of taking the liquidation preference or converting and getting what the common stockholders get. The exact definition of "liquidating event" will often be negotiated and therefore vary from transaction to transaction.

Redemption: If not previously converted, the Series A Preferred Stock is to be redeemed in three equal successive annual installments beginning March 15, 2011. Redemption will be at the purchase price plus an [x%] per annum cumulative guaranteed return.

The investors may seek protection for those deals that will not result in an IPO or a sale of the Company. Most investors do not want to be locked in as a minority stockholder in a private company with no guaranteed exit provision. According to these terms, the

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Company must redeem at a specified amount, which provides investors with some guaranteed return on their investment. Alternatives include (a) a provision stating that the Company may not call the preferred stock for redemption nor may the investors require the Company to redeem their stock and (b) optional redemption after a certain date by either the Company or the investors that, in the case of the investors, may require a minimum series vote or may be on a share-by-share basis. If the Company may call the preferred stock at its option, it could potentially call once the common price exceeds the redemption price and force the investors to take a mediocre repayment on their investment or convert to common stock and lose their preferred position in the Company.

Conversion: The Series A Preferred Stock is convertible into one share of common stock (subject to the anti-dilution provisions below) at any time at the option of the holder and automatically converts into common stock upon:

(i) Consummation of an underwritten public offering with aggregate proceeds in excess of $[x] and a price per share of [x] times the original purchase price per share (subject to adjustment), or

(ii) The vote of a majority of the holders of the Series A Preferred Stock.

Because the control features and other terms of preferred stock are not consistent with public market securities, the preferred stock has to be converted into common stock prior to an IPO.

Anti-Dilution Provisions: Proportional adjustment, subject to standard exceptions, in the event of stock splits, stock dividend, reclassifications and the like; broad-based weighted average dilution protection for any issuance of stock or other equity instruments at a price per share less than the purchase price paid for the Series A Preferred Stock.

Antidilution adjustments increase the amount of common stock received by an investor if the Company issues additional stock at prices which are lower than that paid by the investor. This protects investors if they have over-estimated the value for the Company or if the founders fail to increase the value of the Company by the next round of financing.

Methods for computing the adjustment vary and may result in significantly different outcomes. Also, stock issued for certain transactions may be exempt from the antidilution adjustments, including option grants, warrant coverage in connection with debt, acquisitions or with strategic partners. A weighted average antidilution formula considers the total number of shares issued and the total shares outstanding and results in a less drastic adjustment (from the founder's position) than a full ratchet antidilution formula which automatically reduces the conversion price to the price at which a new issue is sold, even if only a small number of shares are issued.

Pay-to-Play Provisions: If any holder of Series A Preferred Stock fails to purchase its full pro rata portion of any future Qualified Financing (as defined below), either directly or through its affiliates, then such holder will lose its anti-dilution protection and preemptive rights for that

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Qualified Financing and any future equity financings and will have the Series A Preferred Stock it owns converted into common stock immediately prior to the closing of that Qualified Financing (and lose its rights of repurchase and co-sale and any information, inspection, visitation, and registration rights, but retain its lock-up obligations). If such holder participates in such Qualified Financing but not to the full extent of its pro rata share, then only a percentage of its Series A Preferred Stock will be converted into common stock (under the same terms as in the preceding sentence) with such percentage being equal to the percentage of its pro rata share of such Qualified Financing that it did not purchase. A "Qualified Financing" is any equity financing with respect to which (i) holders of Series A Preferred Stock have preemptive rights and (ii) holders of a majority of the outstanding shares of Series A Preferred Stock participate on a pro rata basis.

> *Most portfolio companies will require follow-on rounds of investments after the Series A round. This kind of provision is important in an investor syndicate to ensure that all investors will participate in future fundings of the Company if most of the Investors agree that those fundings have merit. These provisions are generally very specific to the deal in terms of substance and operation.*

Voting Rights, Protective Provisions: The holders of the Series A Preferred Stock will be entitled to that number of votes on all matters presented to stockholders equal to the number of shares of common stock then issuable upon conversion of the Series A Preferred Stock.

Except as otherwise required by law and as described below, the holders of a majority of the outstanding shares of common stock and Series A Preferred Stock (voting together as a single class on an as-converted to common stock basis) shall be required to approve matters which require stockholder vote; provided however, that on the following matters the holders of Series A Preferred Stock, voting together as a single class, will have a separate class vote requiring 67% approval of the total number of votes:

(i) the creation of any senior or pari passu security,

(ii) payment of dividends on common stock,

(iii) repurchase of stock,

(iv) any liquidation event or transaction in which control of the Company is transferred,

(v) an increase or decrease in the number of authorized shares of Series A Preferred Stock,

(vi) any change to the rights, preferences and privileges of the Series A Preferred Stock,

(vii) an increase or decrease in the size of the Board of Directors, and

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(viii) any change in the Company's line of business.

The actions requiring approval by a class vote of the preferred can include virtually anything that is important to the investors and upon which the Company is willing to let the investors have veto power. However, an expansive list of actions requiring investor approval will impede efficient management of the Company and will likely become more of an annoyance to the investors than a benefit. To streamline management yet protect the investors , consider substituting the approval of the preferred nominee to the Board, which may allow quicker action and more flexibility.

Preemptive Rights: The holders of the Series A Preferred Stock shall have the right to purchase a pro rata portion of any securities offered by the Company in the future, except for stock issued to employees under the stock option plan and other standard exceptions. A Series A Preferred Stock holder will have thirty days (30 days) in which to exercise this preemptive right.

This right is typically granted to investors to ensure that the Company does not negotiate new financings with new parties without offering to deal with the present investors. Sometimes investors are required to take "all or none" of the new financing. Sometimes exceptions are made for stock issued in connection with acquisitions and for transactions with customers, suppliers and strategic partners.

Registration Rights: Two (2) demand registrations, unlimited piggyback registrations (subject to underwriter cutbacks) and S-3 registrations, all at Company expense. Demand rights begin upon the earlier of 180 days following an IPO or four (4) years from issuance of the Series A Preferred Stock.

Similar to the rationale for needing a redemption right, since the investors may not control the Board of Directors of the Company, the investors usually negotiate for "demand registration rights" under which the Company contractually agrees to file a registration statement with the SEC for a public offering of the stock "on the demand" of the investors. The number of "demands" is negotiated. In addition, the investors usually receive "piggyback" registration rights under which the investors' shares are included in any "primary registration" statement (where the Company is selling its own stock) or in any "secondary registration" where the Company is filing a registration statement on behalf of one or more of its security holders. "S-3 registration" is a reference to Form S-3 promulgated by the Securities and Exchange Commission. Form S-3 is a simplified (and, therefore, cheaper) form for registration of securities that is available for use by companies that have been public at least one year.

Financial Information: The Investors shall receive standard information rights including audited annual financial reports, unaudited monthly and quarterly financial reports, annual budget and business plan, board packages, as well as standard audit/inspection rights.

Investors generally require annual audited financial statements prepared by a reputable CPA firm.

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Board of Directors: The Board of Directors will be comprised of [x] directors. The holders of the Series A Preferred Stock shall be entitled to elect [x] directors to the Board of Directors. The Company will indemnify directors to the fullest extent allowable under the law.

> *The number of directors elected by the investors will generally bear some relation to the ownership percentage being purchased by the investors (i.e., investors will not usually demand the right to elect a majority of the directors unless the investors are purchasing a majority of the Company. The other directors may consist of specified individuals or officers (designation of the CEO is common) and may be elected solely by the common stockholders or a combination of the investors and the common stockholders. An indemnification agreement for each director (or at least those elected by the investors) is often an additional requirement. Investors not represented on the board of directors often will seek observer rights.*

Right of First Refusal and Co-Sale Right: Series A Preferred Stock holders shall have the right to participate on a pro rata basis (based on their percentage equity ownership on an as-converted basis) in transfers of stock for value by founders, and shall also have a right of first refusal on such transfers.

> *This right will generally be inapplicable to transfers to family and related entities (trusts, solely-owned corporations, etc. The definition of "founders" may be highly negotiated.*

Stock Restriction Agreement: All present holders of common stock who are employees of, or consultants to, the Company will execute a stock restriction agreement with the Company pursuant to which the Company will have an option to buy back at cost a portion of the shares of common stock held by such person in the event that such stockholder's employment with the Company is terminated. 25% of the shares will be released each year from the repurchase option based upon continued employment by the Company.

> *Investors may want to ensure that the present management of the Company has an incentive to remain and discourage leaving the Company by using the buy/back provisions detailed above. The Company may also want the stock back to use to recruit a replacement for the departing employee. Founders may negotiate to have a portion of their shares vested immediately and for accelerated vesting upon termination without cause. This may involve significant tax issues so it must be carefully implemented.*

Transfer of Shares: Investors shall have the unrestricted right to transfer the Series A Preferred Stock, along with all rights pertaining thereto, among any of their affiliates, provided such affiliates hold at least [x] shares of Series A Preferred Stock.

> *Investors routinely want the right to transfer their investments among their related funds and to their individual principals. The minimum shareholding requirement prevents the excessive division of an investment.*

Expenses: The Company shall pay all reasonable out-of-pocket expenses of the Investors, including fees for one legal counsel for the Investors up to $[x].

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Standard Covenants and Representations: The purchase of the Series A Preferred Stock will be made pursuant to a stock purchase agreement drafted by counsel to the Investors and acceptable to the Company, which Agreement shall contain, among other things, appropriate representations and warranties of the Company, covenants of the Company reflecting the provisions set forth herein and other provisions typically found in such agreements, and appropriate conditions of closing.

> *Requiring representations from the Company limits founder liability to the value of the Company; personal representations from founders greatly expand this liability.*

In addition, the Company shall warrant that it has entered into employment agreements with all key employees and proprietary information agreements with all employees and contractors containing provisions satisfactory to the Investors with respect to confidentiality, corporate ownership of inventions and innovations during employment, and non-competition and non-solicitation of employees and customers during and after employment.

> *The determination of who is a "key employee" is fact specific and will vary from one investment to the next.*

Non-Solicitation: From the date of acceptance of this term sheet until the consummation of the financing or the earlier of 90 days from the date of this term sheet or the termination of our negotiations, the Company will not directly or indirectly solicit, initiate, or participate in any discussions or negotiations with, or encourage or respond to any inquires or proposals by any person or group concerning any financing of the Company except (i) the Investors and (ii) those parties identified by the Company as having previously commenced discussions with the Company as becoming potential follow-on investors for this round.

The Company will promptly notify the Investors if any person seeks to initiate with the Company any other discussions or negotiations not contemplated in the immediately preceding paragraph, makes an inquiry or proposal, or requests any information with respect to any proposed financing of the Company, and will disclose to the Investors the terms of any proposal which it may receive in respect of any such proposed financing.

> *This exclusivity clause prevents the Company from shopping the deal, even if negotiations became difficult. Accordingly, it is wise to be comfortable with the deal terms before signing.*

Confidentiality: The Company shall not disclose the existence of either this term sheet or the fact that an Investor is contemplating an investment in the Company, without the prior written consent of such Investor.

> *Investors often do not want disclosure of what investments they are considering and, prior to and sometimes after their investments, do not want their names used by the Company.*

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Expiration: This term sheet shall expire five business days from date of issue if not executed by that time.

Other than the non-solicitation, confidentiality and expiration clauses the undersigned acknowledge that this term sheet does not constitute a binding agreement, but expresses an agreement in principle concerning the principal terms of an equity financing and an undertaking to proceed in good faith to negotiate definitive financing documents.

Venture Investor, L.P.

By: ________________________________

Name:______________________________

Title:_______________________________

Newco, Inc.

By: ________________________________

Name:______________________________

Title:_______________________________

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